STATE OF CALIFORNIA

PETE WILSON, *Governor*

PUBLIC UTILITIES COMMISSION
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May 29, 1996

William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W. Rm 222
Washington, D.C. 20554

DOCKET FILE COPY ORIGINAL

Re: In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996
CC Docket No. 96-98

Dear Mr. Caton:

Please find enclosed for filing an original plus sixteen copies of the REPLY COMMENTS OF THE PEOPLE OF THE STATE OF CALIFORNIA AND THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA in the above-referenced docket.

Also enclosed is an additional copy of this document. Please file-stamp this copy and return it to me in the enclosed, self-addressed, postage pre-paid envelope.

Very truly yours,

Helen M. Mickiewicz

Helen M. Mickiewicz
Principal Counsel

HMM:nas

Enclosures

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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of	)	
	)	
Implementation of the Local Competition Provisions in the Telecommunications Act of 1996	)	CC Docket No. 96-98
	)	

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REPLY COMMENTS OF THE PEOPLE OF THE STATE OF CALIFORNIA AND THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA ON THE NOTICE OF PROPOSED RULEMAKING

I. INTRODUCTION

The People of the State of California and the Public Utilities Commission of the State of California (California or CPUC) respectfully submit these reply comments to the Federal Communications Commission (FCC or Commission) on the Notice of Proposed Rulemaking (NPRM) regarding the implementation of the local competition provisions in the Telecommunications Act of 1996 (hereafter, the 1996 Act).

Approximately 150 parties filed opening comments in response to the NPRM. It was not physically possible for California to read all filings and respond to every issue raised by every party. Consequently, the CPUC has limited these reply comments to those issues it considers the most important for the Commission's consideration. California's silence on issues not addressed here should not be taken as either agreement or disagreement.

II. SCOPE OF THE COMMISSION'S REGULATIONS

The issue of greatest long- and short-term importance to California is that of the Commission's asserted jurisdiction over intrastate matters. California discussed this issue at some length in its opening comments and will not repeat those arguments here. We do, however, see a need to respond to comments of a number of other parties on this question.

A. The FCC Must Balance the Need For National Rules Against the Needs of Individual States

In the NPRM, the FCC argues that a need exists for, and benefits will flow from, enactment of national rules. Yet, the FCC also seems to recognize that some states, including California, have made substantial progress in fostering local competition. The FCC further suggests a realization that impeding further development of these state initiatives, assuming them to be consistent with the 1996 Act, would be an undesirable consequence of imposing national rules. In the CPUC's opening comments, we stressed that national standards and/or rules could be very difficult for the FCC to implement without significantly thwarting some states' progress. In opening comments, Illinois identifies many of the same difficulties, and urges the Commission to balance the needs of those states farther along the road towards fully competitive markets with the needs of those states just starting down that road.[1]

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1. CC Docket 96-98, Opening Comments of Illinois, p. ii.

In California's opening comments, we suggested that the FCC establish a range of guidelines, referred to as a "menu of options", to address each policy question, and allow the states to choose from that menu those options that will best meet the state's needs. We illustrated the model with three policy guidelines for setting call transport and termination rates: explicit rates, bill-and-keep, and banded bill-and-keep.[2] In Table 1, appended here as an attachment, we present a more fully developed "menu of options" model. This model addresses most of the major issues a state may have to confront when arbitrating an agreement or approving a statement of generally available services. The model allows states to choose from among several options the most appropriate solution that will respond to that state's specific circumstances and, at the same time, comport with FCC guidelines.

For example, when setting wholesale rates for retail services, a state would have three options. On an interim basis, states may develop rates using USOA accounts for estimating avoided costs. Or, a state may use a TSLRIC study to develop avoided costs that would then be used to set rates. Yet another option would be for a state to use a TSLRIC study to develop avoided costs for a service and perhaps include a portion of the contribution from the service as an avoided cost. The FCC would determine what USOA accounts or portions thereof are attributable to avoided costs. For the TSLRIC estimates, the Commission could

2. CC Docket 96-98, Opening Comments of California, p. 12.

issue general guidelines about classes of services/expenses that are typically associated with retailing costs. Under the "menu of options" model, each state choosing among the options would have greater assurance that the rules it develops comply with Sections 251 and 252.

While this proposed model addresses most of the major policy issues, the model needs further refinement in at least three areas. The model does not, for example, respond to all of the issues the FCC contemplated in detail in the NPRM for setting national rules. Options could be developed for other areas as the FCC and the states see fit. All parties, including the FCC, must evaluate the myriad combinations of options to make sure that states can freely choose one option to solve a policy issue without eliminating options for another policy issue. As an example, if a state chooses to use an FCC pricing rule for unbundled elements not based on TSLRIC, it would probably not be logical for that state then to establish permanent wholesale rates using TSLRIC estimates for avoided retailing costs. Finally, the proposed guidelines need to be substantially more detailed to make them easy for states to implement. The CPUC welcomes the opportunity to work with parties on further refining the "menu of options" model.

The "menu of options" model meets three important criteria that the FCC identified in its NPRM. First, the model allows the FCC to provide needed guidance to those states just beginning to develop rules for local competition. Second, the model allows states at a more advanced stage of the transition to competition to continue developing and refining their local competition rules with minimal disruption. Third, the model is a solution the FCC can fully implement by the August legislative deadline. In addition to meeting these criteria, this model also allows states a choice when implementing solutions for arbitration. It is more likely that within a range of options, a state can find one option that it can implement within timeframes established in Section 252.

B. The "Menu of Options" is Preferable to Setting Minimum Standards

In its comments, Illinois presents a compelling argument for why the FCC should adopt minimum standards. Illinois also offers some excellent recommendations for the FCC to consider when developing minimum standards. In many respects, Illinois' proposed minimum standards are very similar to the "menu of options" model. However, the "menu of options" model has several advantages which make it a more attractive solution for implementing Sections 251 and 252.

The "menu of options" model provides at least one feasible option for each state to implement. As the FCC notes in the NPRM, experience with implementing local competition varies widely from state to state. The menu model provides options for states that have made substantial progress by affording them the flexibility they need to continue implementing rules consistent with the 1996 Act. At the same time, the model provides other alternatives, also consistent with the 1996 Act, that states with limited staff resources also can implement.

Besides offering a range of feasible options, the menu model balances the need of states that have adopted local competition rules with those states either just embarking on local competition rulemaking proceedings or yet to start developing rules. The former group of states need flexibility to continue regulatory programs that have demonstrated progress, while the latter group needs guidance so that they can avoid "reinventing the wheel".

The menu model allows states to continue to use the expertise and knowledge acquired over many years of overseeing local networks and developing individual states' regulatory approaches. It also allows the FCC to draw upon this knowledge by creating an environment in which both Federal and state regulators can use their expertise in developing a national framework that is both pro-competitive and deregulatory.

In addition to drawing on state and federal expertise, the model allows states to take into account the effect local economies have on decisions made by competitors and by incumbents. As is further discussed in § II.B of these reply comments, markets are regional in nature and do vary. This results in different input prices such as wages, rents, and material expenses. Even though San Francisco and metropolitan Boston may possess similar population densities and diversified economies, rents and wages differ between the two cities. These differences, in turn, produce different cost structures as well as niche opportunities. Silicon Valley has telecommunications needs and opportunities vastly different from those of the

Maryland communities surrounding Washington, D.C., though both areas may have similar population density.

Lastly, the "menu of options" model grants states flexibility in setting rates. Since truly competitive markets produce market prices reflective of underlying costs, the menu model would afford states the chance to manage any rate shock that might otherwise result as market forces and regulators drive rates closer to cost. As an example, if the FCC were to mandate that call termination and transport rates must be set at TSLRIC and that unbundled elements must be set at TSLRIC plus ten percent, many states might be forced to raise residential rates substantially to recover the existing subsidy generated by contribution from the services disaggregated into unbundled components. Unlike the interstate side, the FCC mandate to set call transport and termination rates at TSLRIC would not allow states to implement a carrier common line charge to subsidize residential access rates. These two policies combine to make it very likely that on a short-term basis residential rates would rise significantly.

In the long term the FCC and states can implement universal service programs, but it is unlikely that the federal universal service fund will be operating before the middle of 1997. Nor is it likely that states which have not addressed this issue could resolve it within the nine months that states have to arbitrate agreements. As the 1996 Act acknowledges in establishing the universal service fund, the purpose of introducing competition is not to move costs from business customers to residential customers and from low-cost customers to high-cost customers.

C. **The Commission Should Not Enact National Rules for Local Exchange Competition**

The CPUC maintains the position set forth in opening comments that § 2(b) of the 1934 Act is still in full force and effect, and that §§ 251 and 252 of the 1996 Act do not preempt state jurisdiction over intrastate functions.[3] Nor does California believe that, absent specific language, Congress intended the 1996 Act to produce such a result. Congress did intend that the FCC and state commissions should work together to develop a national policy framework that addresses interstate and intrastate local exchange services. Certainly, the Commission has a major role to play both in promoting a national network and in furthering competition. That role is to guide those states which have yet to open local markets to competition and to coordinate with states which have already initiated programs consistent with the Act's goals. Enactment of rigid national rules offers the serious potential of undermining the 1996 Act's overall intent by reversing the progress of some states, such as California, in the name of national uniformity. Promoting the goals of the Act does not require negating individual state

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3. Section 2(b) of the 1934 Act, also known as § 152(b) of that Act, established state jurisdiction over intrastate communications.

progress. Moreover, the CPUC believes such action would be contrary to the intent of the Act.

California concurs with the statements of New York, Illinois and Michigan who disagree with the Commission's tentative conclusion that its authority takes precedence over state authority. Those states contend that the 1996 Act preserves § 2(b) of the 1934 Act. Further, they argue that because § 601 of the 1996 Act requires explicit Congressional preemption of existing state law, preemption cannot be implied.[4]

MCI and AT&T assert that if the goal of opening markets to competition is to be met, §§ 251 and 252 must apply to both interstate and intrastate interconnection agreements. The Commission, they claim, has the right and the duty to adopt national rules.[5] California disagrees. Dual state and federal regulatory roles <u>and</u> Congress' desire for a national policy framework are not mutually exclusive. New York's views are in accord with this interpretation. New York states that both the implementation of § 251 and the purpose of Part II are to be accomplished by "harmonizing federal/state roles".[6] In California's view, federal and state roles can best be harmonized through policy guidance from the FCC, with states allowed reasonable flexibility to implement the national policy in

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4. CC Docket 96-98, Opening Comments of New York, pp. 4-8; Michigan, p. 3; Illinois, pp. 5-7.

5. CC Docket 96-98, Opening Comments of AT&T, pp. 3-6; MCI, pp. 6-8.

6. CC Docket 96-98, Opening Comments of New York, p. 13.

accordance with the FCC's guidelines. Indeed, for over 60 years the telecommunications industry has flourished under just such a dual regulatory system.

Further, the Commission has before it no evidence to demonstrate that the states will fail to fall into line with the 1996 Act's intent to promote competition. States should be afforded the opportunity to develop rules under broad national guidelines in a reasonable time frame before the Commission steps in. That plainly is the model contemplated by § 252 for negotiation, arbitration, and approval of agreements. Pursuant to the provisions of § 252, the Commission can intervene only if a state will not act. By contrast, in opening its local markets to competition, California has pursued goals mirroring those of the 1996 Act. Specifically, the CPUC has now eliminated all barriers to competitive entry in local exchange markets in California. Premature preemption of state initiatives, such as California's, can only frustrate state efforts to begin fostering competition in their markets.

D. National Rules Will Contravene the 1996 Act's Intent that the Benefits of Competition Should Reach Consumers

Notwithstanding its firm belief that § 2(b) of the 1934 Act is still controlling, the CPUC also believes important policy objectives weigh in favor of intrastate functions remaining within state jurisdiction. Another goal of the 1996 Act is to enhance consumer choices of telecommunications services. Markets are comprised of many components. Some services flourish in one community, but fail miserably in another. A product may be extremely popular in one geographic region, but have no appeal whatsoever two thousand miles away. To the extent that the Commission limits the states' ability to respond to regional market distinctions, the Commission will fail to carry out the 1996 Act's mandate to open all local markets to competition.

Just as daunting is the prospect of small business and residential consumers being forced to take their concerns about local telephone service to Washington, D.C. California does not see how such a result could possibly mesh with the broader Congressional intent to promote local and regional participation in the workings of government, or, for that matter, in the workings of the marketplace. Establishment of national rules, and the concomitant elimination of state flexibility to meet local needs, will render oversight of the marketplace cumbersome and unresponsive to both large and small users.

One anticipated benefit of competition will be the development of niche markets, including the appearance of small companies serving specific ethnic and cultural communities of limited geographical size and scope. This development would support a diverse mix of services and products to meet the widely-varying needs of businesses and individuals, as well as encourage innovation in the ways advanced telecommunications are provided and used in each state. National rules could stifle this development precisely because they would not contemplate local differences. Small businesses, who frequently lack the resources to do so, could find themselves undertaking a regulatory battle, made more expensive by their distance from

Washington, D.C., to preserve their rights under rules enforced by an agency located hundreds or thousands of miles away.

The Commission should not focus on eliminating inherent market differences, but rather should ensure that new entrants receive nondiscriminatory access to diverse markets. That is best accomplished at the state level. New York's comments highlight this concept: "What works for one carrier in one geographic area may not work for another, or for the same carrier in another market". The CPUC agrees.

AT&T argues that federal law should preempt state laws that are inconsistent with the Act. The CPUC contends that the real issue is that state programs which are consistent with the 1996 Act should not be arbitrarily preempted.[7] If no tangible benefit flows from preemption, what purpose is served? New York and Illinois have similarly responded to the question of inconsistent state policies, calling it, at best, premature.

III. OBLIGATIONS IMPOSED ON INCUMBENT LECS

A. Interconnection

The CPUC's existing program for reciprocal compensation for interconnection includes an interim bill and keep arrangement, which California put in place in July, 1995, prior to enactment

7. Indeed, § 251(d)(3) preserves to states authority to establish access and interconnection obligations that are consistent with the 1996 Act, and which do not "substantially prevent implementation" of the requirements of § 251 and the purposes of Part II.

of the 1996 Act.[8] This approach is consistent with §§ 251(b)(5) and 252(d)(2) in that it establishes interconnection obligations of LECs and CLCs, and provides for reciprocal compensation for the transport and termination of local exchange traffic. A number of parties agree that a bill and keep arrangement is a viable mechanism when derived from negotiated agreements. In fact, AT&T and MCI argue that the Commission should order bill and keep as the sole means of reciprocal compensation for traffic exchange.[9]

Ultimately, through our local competition proceeding, the CPUC may designate bill and keep arrangements as one preferred outcome of the structured negotiations approach to achieving interconnection between local exchange service providers, as elucidated in our opening comments.[10] The CPUC has approved and continues to review agreements containing negotiation-based reciprocal compensation mechanisms would more accurately reflect the wide variance in cost structures. Because of this wide variance in cost structures, the Commission's role should not include any national pricing standards for telecommunications transport or termination.

Given the states primary rate setting responsibility under

8. CPUC Decisions (D.) 95-07-054 and D.95-12-056.

9. CC Docket 96-98, Opening Comments of AT&T, p. 70; MCI, p. 52.

10. CC Docket 96-98, Opening Comments of California, p. 41.

the 1996 Act[11], the CPUC advocates establishment of a menu of options from which each state may choose the most appropriate mechanism for carriers to compensate each other for traffic transport and termination. As discussed in § I.A of these reply comments, the CPUC's proposed menu of options would allow states to either establish explicit rates, adopt bill-and-keep arrangements or adopt a banded bill-and-keep similar to Michigan's rules for termination and transport rates.[12] The Commission should not preclude use of any particular construct in the instance where arrangements are negotiated between parties and are consistent with § 252(d)(1) of the 1996 Act.[13] Rather, the FCC's role should be to set general guidelines to assist states in developing specific solutions to requests for arbitration. The FCC could develop a methodology for setting transport and termination rates that states with limited staff resources could utilize. Similarly, the FCC could determine under what conditions a bill-and-keep arrangement results in just and reasonable compensation to all carriers. If bill-and-keep is not appropriate for a class of carriers because of traffic

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11. Telecommunications Act of 1996, § 251(b)(5).

12. NPRM ¶ 243.

13. In fact, the interexchange carriers stand alone in opposing the use of negotiated agreements for reciprocal compensation for traffic transport and termination. Generally, the states, incumbent LECs, and the United States Telephone Association (USTA) concur with California that negotiations are the preferred approach. (See Opening Comments of New York, p. 23; Illinois, p. 85; Pacific Telesis Group, p. 95; SBC Communications, p. 49; and USTA, p. 86.

patterns or types of usage, the FCC could identify these carrier types in its general guidelines.

California does not agree with AT&T and MCI in their interpretation of ¶ 234 of the NPRM, which suggests that the Commission should be responsible for setting nationwide interconnection reciprocal compensation for transport and termination.[14] While the CPUC understands the concerns at the root of the interexchange carriers's (IXC's) position, we cannot agree with the concept that cost structures and accompanying rates should be the same across all jurisdictions. The CPUC, like regulators in many other jurisdictions including the Commission, for the past six or seven years has steadily pursued a transition to cost-based rates. California can think of no rational explanation for the IXCs' implication that rates can be uniform nationally and still reflect underlying cost differences. Also, we take issue with MCI's characterization that the incumbent LEC networks are inefficiently designed because they were built under rate-of-return regulation, and thus necessarily impose disadvantageous interconnection arrangements.[15]

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14. CC Docket 96-98, Opening Comments of AT&T, p. 70; MCI, p. 48.

15. CC Docket 96-98, Opening Comments of MCI, p. 42. It may be true, in some instances, that a LEC's network is not as efficiently constructed as a network in a competitive market might be. But it does not follow that all LEC network structures are *per se* inefficient. Nor does it follow that some inherent inefficiencies in network design and construction mandate national rates. Indeed, California does not see how national rates will make existing LEC networks any more efficient.

Nor does California agree with Pacific Telesis that "bill and keep arrangements can only flow from negotiated agreements, not Commission order".[16] Telesis elaborates on this creative interpretation of the 1996 Act when it states that "[a]lthough the parties may voluntarily agree to 'waive mutual recovery,' [footnote omitted] the Commission has no authority to require **such an arrangement**".[17] Telesis' claim that the Commission lacks authority to adopt a bill-and-keep approach as an appropriate means of compensating interconnecting local exchange carriers for traffic termination is based on Telesis' interpretation of § 252(d)(2) of the 1996 Act. That section sets forth the pricing standards to be applied to charges for transport and termination. Telesis concludes that § 252(d)(2)(A) requires actual, literal recovery of costs. Without addressing the subsequent section of the 1996 Act directly, Telesis appears to dismiss the language in § 252(d)(2)(B), which sets forth the rules of construction of § 252(d)(2). The rules of construction state explicitly that "[t]his paragraph shall not be construed (i) to preclude arrangements that afford the mutual recovery of costs through the offsetting of reciprocal obligations, including arrangements that waive mutual recovery (such as bill-and-keep arrangements)".[18]

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16. CC Docket 96-98, Opening Comments of Pacific Telesis, p. 92.

17. Id. at 95.

18. Telecommunications Act of 1996, § 252(d)(2)(B)(i).

Without saying so directly, Telesis is assuming that an "arrangement" that waives mutual recovery, such as bill-and-keep, must be a negotiated arrangement, and not an arrangement ordered either by the state or by the FCC. California sees no language in the 1996 Act which supports Telesis' interpretation of the word "arrangement" as it is used in § 252(d)(2)(B)(i). California has authorized the use of bill-and-keep on an interim basis as the means of mutual compensation for traffic termination, and expects to revisit the issue later this year. The CPUC expects to consider continuing bill-and-keep, as well as other options for mutual compensation. California does not believe that the 1996 Act prohibits any state or the Commission from employing bill-and-keep as an appropriate means of recovering costs incurred in terminating local exchange traffic. Indeed, California recommends that the FCC consider bill-and-keep as one choice on the "menu of options" states may adopt for compensating local exchange carriers who exchange traffic.

B. **Pricing**

1. **The FCC Should Not Establish National Pricing Principles**

The CPUC agrees with the position taken by New York Public in its comments that the 1996 Act does not require the Commission to establish national pricing principles. As New York points out, § 252(e) allows a state to reject an agreement arrived at by negotiation if it is discriminatory or not consistent with the public interest. If Congress had intended standardized, national pricing principles to be placed into effect it would not have allowed parties to negotiate various pricing schemes. New York also points out that uniform national rules for pricing would be inadvisable from a policy perspective because of variations in technological, geographic, or demographic conditions in local markets. A national pricing principle could prevent a competitor from responding to these local variations.

Further, the CPUC agrees with Michigan's comments that states should retain jurisdiction over the issue of geographic rate deaveraging for interconnection components.[19] Individual states are best suited to examine deaveraging issues based upon market conditions and local costs. As Michigan points out, if new entrants are required to offer an average rate, the incentive for competitive entry is potentially reduced and consumers in low-cost areas may be denied the benefits of competition.[20]

Both AT&T and MCI state in their comments that the Commission should provide meaningful rate structure guidance and prescribe the use of TSLRIC standards to set prices for unbundled elements.[21] AT&T and MCI propose the use of the Hatfield Associates study as the basis for a national TSLRIC methodology, with the Hatfield rates used as price ceilings. The CPUC is currently considering the Hatfield TSLRIC methodology in the Universal Service proceeding underway in California. The

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19. CC Docket 96-98, Opening Comments of Michigan, pp. 15-16.

20. Id. at p.17.

21. CC Docket 96-98, Opening Comments of AT&T, p. v; MCI, p. iii.

Hatfield methodology has been proposed for use in identifying high-cost areas and establishing the universal service subsidy level. Several parties in California, however, oppose the Hatfield methodology because they disagree with the model's application and interpretation of TSLRIC.

As the CPUC stated in its initial comments, the CPUC opposes the use of proxy models to set price floors and ceilings which constrain state rates for interconnection and unbundled elements. Further, the proxy models currently proposed only provide residential service cost estimates. These models have not estimated the costs for business loops. For example, they do not take into account that business loops traditionally are shorter on average than residential loops, or that business service has different geographic distributions. Lastly, the Hatfield model is based on the Benchmark Cost Model, which was designed to identify and estimate costs in high cost areas. Therefore, the CPUC urges the Commission to refrain from adopting a detailed national pricing framework for interconnection and unbundled elements based on any proxy model such as the Hatfield study. Instead, the FCC should allow states such as California to continue their efforts to set company-specific cost-based prices because these efforts are consistent with the Act. Moreover, the CPUC believes that § 251(d) 3 of the Act limits the FCC's ability to set national floors and ceilings because states are allowed to develop their own access regulations as long as they are consistent with the Act and do not prevent implementation of § 251.

2. The CPUC agrees with the FCC's tentative conclusion that use of the ECPR would be inconsistent with the 1996 Act

The FCC tentatively concludes that use of the efficient component pricing rule (ECPR) to set prices for interconnection and unbundled elements would be inconsistent with the § 252(d)(1) requirement that these prices be based on cost. (NPRM ¶148.) The CPUC agrees with this conclusion. The premise of the ECPR is that prices should be set so that the incumbent LEC provider of unbundled elements is made "whole" whether the incumbent LEC or a competitor provides the service to the end user. As MCI states in its comments, "[t]he basic flaw in this approach is that it starts from existing revenue requirements and constructs contribution markups necessary to raise that level of revenue regardless of market conditions".[22] As the FCC states, this methodology is inconsistent with the intent of the 1996 Act because "[u]nder the ECPR, competitive entry does not drive prices to competitive levels". (NPRM ¶147.) The 1996 Act gives clear direction to both the FCC and the states to employ the forces of competition in telecommunication markets; use of the ECPR will not promote this goal.

22. CC Docket 96-98, Opening Comments of MCI, p. 71.

3. **The Commission Should Not Prohibit the Setting of Rates for Some Services Below Cost**

The CPUC agrees with those parties who oppose the setting of national rates, and who advocate that the states should take the lead in establishing reasonable resale rates, as well as terms and conditions of service. (See for ex., Opening Comms. of Pacific Telesis Group, pp. 84-89.) The CPUC disagrees, however, with Pacific Telesis' (Telesis) assertion that the "pricing of resale services should not require discounts from services already priced below cost". (Id. at 89.) Telesis' subsidiary local exchange carrier, Pacific Bell, has asserted the same position before the CPUC, which has rejected that position. The assertion in Opening Comments points up once again the importance of the states' retaining jurisdiction over intrastate matters.

In a March 1996 decision which established discounted wholesale rates for many local exchange services, the CPUC addressed Pacific Bell's argument. Specifically, the CPUC noted that Pacific Bell's rate structure, redesigned effective January 1, 1995 to accommodate the start of intraLATA toll competition, includes residential basic exchange rates set below reported direct embedded costs. The CPUC further noted that Pacific recovers, through contribution from rates for other services, the difference between the residential basic exchange service rate and the reported per-access-line cost of providing the service.

> We reject the LECs' arguments that pricing wholesale residential service equal to the 1FR and 1MR retail rates [less avoided costs] would constitute unlawful confiscation or unfair compensation. Pacific's claims regarding its compensation levels for

> residential service [cite omitted] ignore revenue which it receives from various sources and which subsidizes residential customers. . . . Moreover, in considering whether Pacific and GTEC will be adequately compensated under the adopted wholesale residential rates, it is appropriate to consider all of the revenues which the LECs receive associated with reselling residential service, not just the revenues from the basic access line itself. This complete revenue package includes intraLATA toll, switched access from IECs, and vertical features. In addition to the monthly rate for local exchange service, residential subscribers also pay a federally mandated end-user common line (EUCL) charge. (CPUC's D.96-03-020, slip op., pp. 33-34.)

Consequently, Pacific Bell is made whole for the cost of providing residential basic exchange service. Moreover, Telesis' argument is based on a direct-embedded cost standard, and not a TSLRIC standard. TSLRIC has yet to be determined, and may reveal a different cost-price relationship than does DEC. Telesis' claim to the Commission that requiring "local exchange resale prices to be set below cost would be confiscatory" is without merit. Strict application of Telesis' position would produce rates in high-cost areas that could not be set below-cost and subsidized by the universal service fund.[23] The key policy goal should be reasonableness of rate design, not national consistency.

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23. Telesis' position also potentially would conflict with § 254(b)(3), which provides that consumers in rural and high-cost areas should pay rates "reasonably comparable" to rates in urban areas.

IV. **CONCLUSION**

For the reasons stated, the CPUC urges the commission to adopt a "menu of options" approach to setting guidelines for the states to implement. California also recommends that the Commission not to establish national rules for local exchange competition, or national rates.

Dated: May 29, 1996

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ATTACHMENT